Supreme Court, U.S.
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No. 99-552

IN THE

Supreme Court of the United States

SUN INTERNATIONAL NORTH AMERICA, INC.,
Petitioner,

v.

FRED LOWENSCHUSS, individually and as Trustee of FRED LOWENSCHUSS, I.R.A., LAURANCE LOWENSCHUSS, I.R.A., and FRED LOWENSCHUSS ASSOCIATES PENSION PLAN,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF FOR PETITIONER

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12 pp

TABLE OF AUTHORITIES

CASES Page(s)

A.H. Phillips, Inc. v. Walling, 324 U.S. 490 (1945) 5

Belcufine v. Aloe, 112 F.3d 633 (3d Cir. 1997) 9

Caterpillar v. Lewis, 519 U.S. 61 (1996) 9

Commissioner of Internal Revenue v. Clark, 489 U.S. 726 (1989) 5

Erlenbaugh v. United States, 409 U.S. 239 (1972) 3

Munford v. Valuation Research Corp., 98 F.3d 604 (11th Cir. 1996) 1

Quality Tooling, Inc. v. United States, 47 F.3d 1569 (Fed. Cir. 1995) 8

In re SKC Corp., 54 B.R. 165 (Bankr. D.N.J. 1984) 9

Things Remembered, Inc. v. Petrarca, 516 U.S. 124 (1995) 9

United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988) 3

United States Nat'l Bank v. Independent Ins. Agents, Inc., 508 U.S. 439 (1993) 5

STATUTES AND RULES

11 U.S.C. § 544 .....3, 4

11 U.S.C. § 545 .....3, 4

11 U.S.C. § 546(e) ..... *passim*

11 U.S.C. § 547 ..... 3, 4

11 U.S.C. § 548 4

11 U.S.C. § 548(a)(1)(B) 3, 4

11 U.S.C. § 548(b) 3

11 U.S.C. § 549 4

11 U.S.C. § 550 ..... 3, 4

28 U.S.C. § 157(a) 9

28 U.S.C. § 1447(c) 9

28 U.S.C. § 1447(d) 9

28 U.S.C. § 1452 ..... 7, 8, 9

28 U.S.C. § 2111 9

F.R. Bankr. P. 9027 7

REPLY BRIEF FOR PETITIONER

This case presents a clear, acknowledged inter-circuit conflict over the statutory interpretation of important provisions of the Bankruptcy Code ("*Code*"). In the end, respondents are forced to concede that this case presents such a conflict, *see* Opp. at 11, but they try to hide from that conflict by conjuring purported factual distinctions and claiming that the *Code* provisions at issue are somehow not sufficiently important to warrant this Court's resolution of the conflict. Respondents' contrived efforts to manufacture factual complexity cannot overcome the fact that their proffered distinctions were never so much as suggested by the Third Circuit, which instead forthrightly acknowledged the circuit conflict that its decision in this case created. *See* Petition at 19-20. Because the Third Circuit's decision conflicts with the Eleventh Circuit's decision in *Munford v. Valuation Research Corp.*, 98 F.3d 604 (11th Cir. 1996), and is inconsistent with the text and structure of the *Code*, plenary review clearly is warranted.

1. Respondents assert that there is a "critical factual distinction" between the transfer in *Munford* and the one in this case because a second protected entity, the stockbroker Merrill Lynch, was also an intermediary in the transfer from Resorts to respondents. Opp. at 11-14.[1] The Third Circuit, however, never adverted to that "critical" distinction, much

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[1] Respondents' attempt to distinguish between the financial institution in this case, Chase, and the financial institution in *Munford* is frivolous. Opp. at 11-12. Both here and in *Munford* the financial institution was an intermediary in the transfer of funds and shares between the debtor and the shareholders.

less relied on it to reject petitioner's arguments here. Instead, the Third Circuit recognized that its reasoning cannot be reconciled with the analysis adopted by the *Munford* majority, and it expressly stated that it was more persuaded by the dissent in that case. Pet. App. at 21a. The Third Circuit, in fact, essentially rejected the position respondents now advocate, finding that this case involved "similar payments" as were made in *Munford*. *Id.* at 20a. Respondents' manufactured "factual distinctions" are irrelevant to the conflict between the circuits that petitioner presents to the Court for resolution in this case.[2]

Contrary to respondents' suggestion, this case does not involve a matter of textual interpretation on the one hand and policy arguments on the other. As the petition made clear, the Third and Eleventh Circuits are sharply divided over two alternative textual readings of the *Code*. *See* Petition at 17-21. The Eleventh Circuit was confronted in *Munford* with the same question presented to the Third Circuit here: whether section 546(e) provides an exception to *any* transfer in which a protected entity happens to be involved as an intermediary; or whether section 546(e) applies *only* to transfers in which a protected entity is directly involved either as the debtor or as the transferee. The two circuits

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[2] Respondents' efforts to explain away the disarray among district courts are similarly without merit. *See* Opp. at 15-16. Those courts, like the circuit courts, have been confronted with determining whether the section 546(e) exception applies to transfers from a bankrupt to a transferee where the transferee is not a protected entity under section 546(e).

reached conflicting conclusions based upon their analysis of the text and structure of the statute.

The Eleventh Circuit's decision in *Munford*, unlike the Third Circuit in this case, observes a fundamental principle of statutory interpretation: that "individual sections of a single statute should be construed together." *Erlenbaugh v. United States*, 409 U.S. 239, 244 (1972). The Eleventh Circuit recognized that, because section 546(e) is an *exception* to a class of avoidable transfers of a debtor's interest, it must be read in the context of the provisions of the *Code* that generally govern an avoided transfer—precisely the type of "holistic" approach to interpreting the *Code* that this Court mandated in *United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). *See* Petition at 18-20 & n.12. The general rules regarding avoided transfers are found in *Code* sections 544, 545, 547, 548(a)(1)(B), 548(b), and 550. *See Code* § 546(e). Section 550 is particularly significant because it governs the recovery of property that was the subject of a transfer that the trustee may avoid under sections 544 and 548(a)(1)(B), among others. *Id.* § 550.[3] Of course, if the property is not recoverable from a party in the first place, then there is little point in providing an exception (such as the section 546(e) exception at issue here) to shield that property from the

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[3] Respondents' carefully worded assertion that section 546(e) "operates without reference to the requirements of the more general section 550," Opp. at 14 n.9, is misleading. Although not specifically cited in 546(e), section 550 is an essential part of the *Code* provisions to which section 546(e) provides an exception.

trustee's avoidance powers. For that reason, it is dispositive for present purposes that the trustee may only recover property that was involved in an avoidable transfer from a "transferee." *Id.* § 550.

Thus, as the Eleventh Circuit correctly recognized, section 546(e) is not implicated if a financial institution or other protected entity is involved in a transfer only as a conduit or intermediary, because under the settled interpretation of section 550 such a conduit is not a "transferee" from which property may be recovered by the trustee. As the Eleventh Circuit and other courts of appeals have understood, a "transferee" must possess a beneficial interest in the transferred property. Petition at 13. This result flows directly from the interaction of the *Code* provisions specifying the transfers a trustee may avoid—sections 544, 545, 547, 548 and 549—and section 550, the provision governing recovery of property that is the subject of an avoidable transfer. The exception in section 546(e) then applies to those transfers reachable by the trustee, *i.e.*, transfers to transferees. The Eleventh Circuit concluded that section 546(e) was not applicable in *Munford* because the only transferees were shareholders, a class of persons who it held do not enjoy protection from the general avoidance power.

The Third Circuit, by contrast, began and ended its analysis by interpreting the language of section 546(e) in isolation, concluding that the "plain language" of that provision could be and ought to be interpreted without reference to the other pertinent provisions of the *Code* to which section 546(e) creates an exception. Pet. App. at 21a. The Third Circuit reasoned that, because section 546(e) standing alone does not specifically state that the protected

entities must be involved in the transfer as either a debtor or a transferee, any involvement by a protected entity is sufficient to invoke the exception. That approach not only ignores this Court's repeated cautions against interpreting statutes on the basis of "isolated words or sentences," *United States Nat'l Bank v. Independent Ins. Agents, Inc.*, 508 U.S. 439, 455 (1993), but also contravenes the basic rule that requires statutory exceptions to be construed narrowly in order to avoid situations in which an exception would effectively destroy the primary application of the statutory rule to which Congress has carved an exception. *Commissioner of Internal Revenue v. Clark*, 489 U.S. 726, 739 (1989); *see also A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945). Indeed, the Third Circuit's purported "plain language" approach impermissibly produces the anomalous result that the exception in section 546(e) applies to transfers that cannot be reached by the general avoidance and recovery provisions of the *Code*.[4]

The Third Circuit's statutory analysis also conflicts with the actual text of section 546(e) itself. As respondents note,

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[4] Moreover, the terms of section 546(e) do not insulate from the trustee's avoidance power a "transaction," Opp. at 11, that "involves" a settlement payment, but rather a "transfer" that "is" a settlement payment. Thus, the "transfer" that may be excepted under section 546(e) must necessarily be an otherwise avoidable transfer under the *Code*. The record is clear that an avoidable transfer was not made "by" or "to" Chase or Merrill Lynch because neither of them is the debtor or transferee from whom recovery could have been made. The avoidable transfer at issue is between Resorts and respondents.

the Third Circuit's "plain language" approach led it to conclude that there was "no basis" to "leave former public shareholders outside of the protections of section 546(e)." Opp. at 6. Former public shareholders, of course, are not one of the protected entities delineated in the text of section 546(e). The Third Circuit's "plain language" approach, thus, has grafted a new class of new protected entities—former public shareholders—into the text of section 546(e).

2. Respondents are mistaken in their contention that the issues presented by this case "are not likely to be important in the bankruptcy context in the future" because leveraged buyouts ("LBOs") are less frequent today than they were in the 1980s. Opp. at 8. As an initial matter, that contention overlooks the fact that the question presented by petitioner is being actively litigated today; indeed, the circuit conflict at issue has arisen within the past two years. Nor do respondents acknowledge that the lower courts continue to be confronted with the precise issue presented by this case. *See* Petition at 25 (citing cases).

Moreover, contrary to respondents' assertions, it is not petitioner's position that the Third Circuit's statutory analysis is, or could be, confined solely to the LBO context. *See* Opp. at 7-10. While LBOs obviously are an important factual scenario in which this issue can arise, the Third Circuit's broad holding regarding the scope of section 546(e) is not limited to the LBO context. The practical ramifications of the Third Circuit's holding are vast. Under the Third Circuit's construction of section 546(e), any transferee of a debtor's interest in property may escape the trustee's avoidance and recovery powers simply by having the transaction run through a financial institution, a stockbroker, or another protected entity. Even respondents reason that

under the Third Circuit's view of section 546(e), anytime Merrill Lynch (and presumably any other stockbroker) is involved in the transfer of funds from a debtor, the property is exempted from the avoidance power. *See* Opp. at 13 ("if an entity is a stockholder, the Code treats all transfers of property, stock or cash to have taken place in a stockbroker-customer relationship"); *id.* at 14 (because Merrill Lynch is a stockbroker, "it follows that section 546(e) has specifically exempted [the] payments" at issue); *see also id.* at 14 n.8. Consequently, any transferee can circumvent the trustee's general avoidance and recovery power by employing a stockbroker to process the transfer of a debtor's interest in property. That is far from what Congress could have intended when it enacted section 546(e), let alone what the language of the statute would support.

3. In a final effort to distract the Court from this important question of bankruptcy law that divides the courts of appeals, respondents claim that there is a "jurisdictional flaw" underlying this case that would "likely" bar the Court from reaching the merits. Opp. at 16. Respondents are wrong. Respondents argue that the removal of this case to the Bankruptcy Court for the District of New Jersey pursuant to 28 U.S.C. § 1452 and Bankruptcy Rule 9027 was improper. *Id.* at 16-18. The Third Circuit rejected precisely the same argument out of hand in a footnote, concluding that the argument is so lacking in merit that it warranted no discussion whatsoever. Pet. App. at 22 n.12.

Respondents ask this Court to reconsider the jurisdictional argument rejected by the Third Circuit, but they do not bother to provide any principled basis to support their claims or even to describe in so many words the nature of their jurisdictional objection. Indeed, respondents do not cite

to a single decision by a court of appeals supporting their claim or suggesting that the Third Circuit erred in exercising jurisdiction.[5] All respondents say is that the "majority of cases" that purportedly have considered the propriety of removal in analogous circumstances have barred such removal. But the "majority of cases" referenced by respondents, Opp. at 17-18, amount to a handful of bankruptcy and district court decisions interpreting 28 U.S.C. § 1452.

Further, the alleged defect in the case cannot fairly be considered "jurisdictional" even on respondents' view of the facts, since even respondents acknowledge that the case could properly have been "transferred" to the District of New Jersey under a different statute. Thus, respondents necessarily must acknowledge that the Bankruptcy Court had subject matter jurisdiction over this case. *Id.* at 18 & n.12. That is fatal to their argument, because it makes clear that the alleged defect amounts at most to a miscitation that could not have affected the parties' substantial rights. That is precisely the type of error that Congress has long instructed this Court

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[5] The Court of Appeals for the Federal Circuit commented on a similar jurisdictional challenge based on an allegedly improper removal under 28 U.S.C. § 1452. *See Quality Tooling, Inc. v. United States*, 47 F.3d 1569 (Fed. Cir. 1995). That court, like the Third Circuit, rejected the challenge. The Federal Circuit held that removal of an action from the federal court of claims in Washington, D.C., to a District Court in Alabama sitting in bankruptcy was authorized under 28 U.S.C. § 1452. *Quality Tooling*, 47 F.3d at 1572.

to disregard on certiorari. 28 U.S.C. § 2111.[6] Moreover, the alleged defect in the removal was procedural, and if it is not raised in a motion to remand within thirty days, it is waived. *See Caterpillar v. Lewis*, 519 U.S. 61, 69 (1996); *Belcufine v. Aloe*, 112 F.3d 633, 638 (3d Cir. 1997). Respondents waived their objection to the removal here because they failed to oppose it within thirty days. *See Things Remembered, Inc. v. Petrarca*, 516 U.S. 124, 127, 129 (1995) (28 U.S.C. § 1452, the bankruptcy removal statute, is to be read in conjunction with 28 U.S.C. § 1447(d), regarding removal generally, which in turn must be read with 28 U.S.C. § 1447(c)). This Court plainly has jurisdiction to decide this case.[7]

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[6] At worst, respondents' complaint is that the matter should have gone first to the District Court of New Jersey, which could then refer the matter to the Bankruptcy Court under 28 U.S.C. § 157(a). Opp. at 18. The District of New Jersey has in place a standing order of referral that would have sent this case to the Bankruptcy Court in any event. *See In re SKC Corp.*, 54 B.R. 165, 168 (Bankr. D.N.J. 1984).

[7] Of course, if the Court were somehow to determine that the lower courts are divided about the application of 28 U.S.C. § 1452, and that that issue warrants resolution at this time, that would be a reason *for*, rather than *against*, review here. Respondents themselves, however, have provided a telling assessment of that purported jurisdictional defect by failing to cross-petition on that question, and there is no good reason for this Court not to let the matter rest where respondents themselves were content to have it remain.

CONCLUSION

For the foregoing reasons, and for those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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